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TAGS: ECON EPET ENRG EINV ES
SUBJECT: ELECTRICITY SECTOR LIQUIDITY CRISIS DRAGS ON

REF: A. 07 SAN SALVADOR 2383
¶B. 08 SAN SALVADOR 0905

¶1. (SBU) SUMMARY: Electricity companies are continuing to warn of potential blackouts if the GOES fails to find a durable solution to address liquidity problems caused by unpaid energy subsidies. U.S.-owned electricity distributor AES asked the GOES to pay $12.3 million by September 22 and $19 million in October to allow AES to cover its monthly energy bills. Faced with similar problems in July and August, the GOES extended the payment deadline and negotiated a last-minute payment to avert a crisis (Ref B). Although monthly subsidy costs are falling, power companies are concerned that the GOES and state-owned generation company still have not identified funds to resolve the short-term cash-flow problems. Companies are also negotiating for long-term solutions to reduce subsidies and establish more frequent payments. END SUMMARY.

SHORT-TERM PAYMENTS NEEDED

¶2. (U) After electricity subsidies rose from $4 million per month in 2007 to over $30 million per month by June 2008, power companies began to press the government to make early subsidy payments. Under a temporary scheme established in 2006, energy companies have been forced to carry debts between biannual "tariff resets" in April and October, when the GOES negotiates subsidy payments to keep electricity rates frozen. (Ref A) As oil prices declined and production of cheaper hydroelectricity increased in August, the subsidy burden has declined but industry sources expect the subsidy debt to reach $180 million by October.

¶3. (SBU) As the outstanding debt for unpaid subsidies approached 50% of its annual revenues in July, AES told the GOES it simply does not have enough working capital to carry this debt and still pay its energy bills. With AES warning of potential blackouts in July and August, the GOES twice extended the deadlines and negotiated payments to avert a crisis. In both cases, the government leaned on the state-owned generator, CEL, to use credits against future power purchases to cover part of the subsidy. In August, AES and one generator, Cenergica, also reportedly came up with funds to cover part of the shortfall. With CEL,s resources exhausted, some industry sources report the GOES may issue short-term bonds to finance part of the subsidy.

¶4. (SBU) AES requested early subsidy payments of $12.3 million by September 22 and $19 million in October, so that AES can pay its monthly energy bills. The company warns that without this payment, the government will be forced to call in a bank bond to cover AES, energy bills. In theory, this would require the government to disconnect AES from the electricity grid, effectively cutting off 80% of El Salvador,s electricity consumers. Though the GOES can waive this requirement, the use of AES, bank bond would

reverberate through El Salvador,s energy sector as banks would reassess risks and generators would require advance payments from AES for power purchases. After a September 19 meeting with the government, AES reported that the GOES promised a partial payment by September 22 and will grant a one-week extension to pay the remaining $9 million. There have been a series of meetings between the GOES and the companies, but thus far the GOES has merely extended the September 22 payment date for a week, assuring the companies that they would work something out before the new deadline.

TOWARDS A LONG-TERM SOLUTION

¶5. (U) To bring an end to these monthly crises, the GOES has taken steps to reduce industrial subsidies and shift to more frequent subsidy payments. Beginning on August 12, the energy regulator reduced industrial electricity subsidies by 40%. Under a three-step phase out plan, the remaining subsidy will be phased out in April and October 2009. This phase-out will not affect residential customers who consume nearly half of El Salvador,s electricity.

¶6. (SBU) The Ministry of Economy is considering a proposal to amend electricity regulations to start making quarterly subsidy payments. Power companies initially pressed for monthly payments but industry sources say they can live with quarterly payments if the amendments also establish a trigger for extra subsidy payments when the difference between real and subsidized energy payments gets too high. AES reports that the GOES is working to approve and implement these amendments by October 12, when the tariff reset process sets a payment schedule through April 2009.

COMMENT:

¶7. (SBU) These monthly crises send a negative signal to investors, which is particularly ill-timed as AES receives a visit next month from potential investors in its 250 MW coal-fired generation plant. Initial steps to phase out industrial subsidies are positive but leave most of the subsidy intact through the 2009 elections. In the medium-term, lower oil prices and higher hydroelectricity production should also help reduce subsidies, but the GOES still has a $180 million debt to cover.

¶8. (SBU) Even if it works out a plan to pay off this debt, the current administration is likely to leave a weakened energy sector and increased short-term debt for the next administration to resolve. The new Salvadoran President should look to increasing electricity prices for domestic users, who have not seen a price increase since June 2006. Still, the new president will likely be reluctant to force that bitter pill on the public early in his administration. President Saca may be able to claim when he leaves office next year that he mostly kept his promise over the last three years of his administration to not increase electricity prices. However, his successor and the Salvadoran public will learn shortly thereafter that there is no such thing as a free lunch.
GLAZER